

Nauset Market Commentary Second Quarter 2018

Market Performance Recap: **Stocks Post Gains on Record Earnings**

Solid GDP growth and record corporate earnings helped US stocks stage a choppy rebound from Q1 lows. Overall, the Russell 1000 US stock index gained +3.6% paced by sharp gains in energy, tech and real estate, while financial and industrial sectors lagged. International stocks slumped with developed country EAFE index off -1.2%, while the Emerging Markets index dropped -8.0%. Rising yields and another Fed rate hike led to a flat +0.0% return for the Barclays Intermediate Gov't/Credit bond index.

Economic & Market Discussion: **Impact of a Global Trade War**

Trade war reporting has dominated recent headlines – new tariffs, retaliations, angry firms and Presidential tweets. What is the President trying to accomplish? How will the ongoing trade policy affect the US and global markets? Here is what is happening and what to watch for.

- **Tariffs Aimed at Trade Imbalances** – President Trump's tariff action is attempting to increase US exports, create US jobs and protect US intellectual property. Increasing costs on imported goods via tariffs can provide a domestic advantage for US producers in certain industries like steel. The global response is to levy retaliatory tariffs on US agricultural, auto and medical goods among other exports. In the short run, the likely result of widespread tariffs will be higher prices for all consumers on many goods. Whether or not the US benefits from the current tariff activity remains to be seen.

America's Top Trading Partners

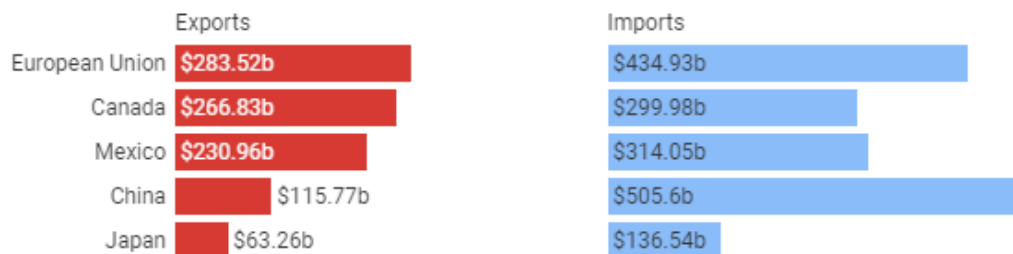


Chart: The Conversation, CC-BY-ND • Source: [The International Trade Administration](#) • [Get the data](#)

- **Right Idea, Wrong Tactics?** – Fair trade is a legitimate concern as the US has suffered over recent years from unbalanced trade deals. Ironically, the US created many of these deals decades ago to assist other countries in exchange for financial and trade leadership, making the US dollar the world's reserve currency. However, the damage to certain industries has been obvious and painful. The question is: will tariffs reverse that damage or simply create a tax for all with a small benefit for a few industries? International trade issues are complex and tariffs, a blunt instrument, have never had a positive long-term economic impact. A better approach might be to use the US-led World Trade Organization to revise and level out policies in cooperation with our trading partners.
- **Market Impact** – We expect trade fears to continue to buffet markets as new trade terms and deals are negotiated. Intensifying trade conflict is creating uncertainty and has the potential to curtail investment spending on export development, which could send the US and other major economies into an economic slowdown or possibly recession. For that reason, we are monitoring the tariff wars closely for economic and market damage.

Portfolio Strategy: **Continued Caution and Low(er) Expectations**

Continued strong earnings and positive growth feed into our current strategy to favor stocks over bonds. However, fully-valued stock levels and volatility from rising rates and trade policy uncertainties will likely keep returns well below last year's pace.

- **Diversify Stock Holdings** – As we have in the past several quarters, our slight stock overweight focuses on US tech, finance and health care sectors coupled with both non-US developed and emerging market allocations.

- Fixed Income: Seeking Opportunities While Playing Defense – We recently reworked our fixed income allocation using two funds that we believe can navigate the current rising rate environment – one employs strong credit research and active duration management, and the other uses a broad, global toolkit to find fixed income opportunities. In doing so, we reduced or eliminated our direct exposure to high yield and emerging market bonds.
- Ready for More Volatility– We continue to use alternative and real asset investments to seek returns with low correlations to major market movements as a way to manage risk. We expect these two areas plus cash holdings to lessen portfolio volatility while providing different sources of return over time.

Market Index	Market Performance % Change for Periods Ended 6/30/2018				
	Second Quarter	2018 YTD	1-Year	3-Year Annual.	5-Year Annual.
Russell 1000	3.57	2.85	14.54	11.64	13.37
MSCI EAFE – Non-US	-1.24	-2.75	6.84	4.90	6.44
Russell 2000	7.75	7.66	17.57	10.86	12.46
MSCI Emerging Markets Equity	-7.96	-6.66	8.20	5.60	5.01
DJ US Real Estate	7.78	1.41	5.19	8.88	8.61
NASDAQ 100	6.31	8.79	22.31	14.62	17.15
Barclays Gov't/Credit Interm. Bond	0.01	-0.98	-0.58	1.16	1.60
Wilshire Liquid Alternative	-0.58	-1.57	1.31	0.75	1.32
3-Month T-Bill	0.41	0.63	1.24	0.59	0.36